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No. 88-1275

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

LEWIS R. CRIST, RECEIVER FOR TRANSIT CASUALTY COMPANY
Petitioner

v.

WAL-MART STORES, INC. AND
ALEXANDER AND ALEXANDER, INC.
Respondents

MOTION FOR LEAVE TO FILE AND AMICUS CURIAE BRIEF OF TEXAS PROPERTY AND CASUALTY INSURANCE GUARANTY ASSOCIATION IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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22 pp

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The Texas Property and Casualty Insurance Guaranty Association hereby respectfully moves for leave to file the attached brief *amicus curiae* in this case. The consent of attorney for the Petitioner has been obtained. The consent of the attorney for the Respondent was requested but refused.

The interest of the Texas Property and Casualty Insurance Guaranty Association arises from the fact that it functions as a statutory association whose duty is to pay certain "covered claims" arising from insurance insolvencies. The instant case involves a finding of *illegality* which declared void an insurance policy issued to Respondent Wal-Mart, Inc. by Transit Casualty Company, now represented by Petitioner Receiver Lewis I. Crist. The Texas Property and Casualty Insurance Guaranty Association has paid certain claims made under this putatively void policy.

The Court of Appeals found that the doctrine of *pari delicto* applied to bar an insurance receiver from recovering on a policy of workers' compensation when, prior to receivership, the insurance company and the insured entered into an illegal premium arrangement. *Amicus curiae* requests permission to address the concept of *pari delicto* as applied to insurance company receivers, as such issue is of compelling national interest in the insurance industry. If the argument of the Texas Property and Casualty Insurance Guaranty Association is accepted, this argument would be dispositive of this case.

Respectfully submitted,

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PROOF OF SERVICE

I hereby certify that this motion and brief are being sent to the counsel for Petitioner and the counsel for Respondent as follows via certified mail on this day of March, 1989.

_____

KARL L. RUBINSTEIN

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QUESTION PRESENTED

Amicus Curiae Texas Property and Casualty Insurance Guaranty Association agrees that the Question Presented in the Petition filed by Petitioner adequately states the issue before this Court.

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
OPINION	2
JURISDICTION	2
STATEMENT OF CASE	2
NATURE OF APPLICANT'S INTEREST	3
SUMMARY OF THE ARGUMENT	5
THE ARGUMENT	6
I. THIS COURT SHOULD HEAR THIS CASE ON THE MERITS SINCE THE EIGHTH CIRCUIT DECISION MISAPPLIES THE DOCTRINE OF PARI DELICTO IN A FASHION WHICH FORECLOSES THE DUE PROCESS RIGHTS OF THE INSURANCE RECEIVERS	6
II. THE COURT OF APPEALS INVADED THE POLICE POWER OF THE STATE INSURANCE REGULATOR BY REFUSING TO ENFORCE THE PREMIUM LIABILITY	12
CONCLUSION	14

TABLE OF AUTHORITIES

Case	Page
AIMS Enterprises v. Muir, 609 F. Supp. 257 (M.D. Pa. 1985)	8
Alpha Beta Food Markets, Inc. v. Retail Clerks' Union Local 777, 45 Cal. 2d 764, 291 P. 2d 433 (1955)	11
Anderson v. Great Republic Life Ins. Co., 41 Cal. App. 2d 181, 106 P. 2d 75 (1940)	8
Baldwin-United Corp. v. Garner, 283 Ark. 385, 678 S.W.2d 754 (1984), *cert. denied,* 471 U.S. 1111 (1985)	10
Bonhiver v. Graff, 311 Minn. 111, 248 N.W.2d 291 (1976)	13
Bowen Motor Coaches, Inc. v. New York Casualty Co., 139 F.2d 332 (5th Cir. 1943)	12
Connolly v. Pension Benefit Guaranty Corp., 475 U.S. 211, 106 S. Ct. 1018 (1986)	11
D'Oench, Duhme & Co. v. Federal Deposit Ins. Co., 315 U.S. 447, 62 S. Ct. 676, 86 L. Ed. 956 (1942)	10
English Freight Co. v. Knox, 180 S.W.2d 633 (Tex. Civ. App.-Austin 1944, writ ref'd w.o.m.)	9
F.D.I.C. v. Oehlert, 252 N.W.2d 728 (Iowa 1977)	13
Gallin v. Burdick, 152 Misc. 468, 273 N.Y.S. 456 (Sup. Ct. 1934), *aff'd,* 265 N.Y. 492, 193 N.E. 286 (1935)	8
Garris v. Carpenter, 33 Cal. App. 2d 649, 92 P.2d 688 (1939)	9
Insurance Commissioner v. South Carolina Life & Health Ins. Guaranty Ass'n, 267 S.C. 378, 228 S.E.2d 273 (1976)	8
Kueckelhan v. Federal Old Line Ins. Co., 69 Wash. 2d 392, 418 P.2d 443 (1966)	8
Magnusson v. American Allied Ins. Co., 290 Minn. 465, 189 N.W.2d 28 (1971)	13
McCarthy v. Knox, 186 S.W.2d 832 (Tex. Civ. App. — Galveston 1945, writ ref'd w.o.m.)	9
Penn General Casualty Co. v. Pennsylvania, 294 U.S. 189 (1935)	8
Sheeran v. Sitren, 168 N.J. Super. 402, 403 A.2d 53 (1979)	9
Wal-Mart Stores, Inc. v. Crist, 664 F. Supp. 1242, 1268 (W.D. Ark. 1987), *rev'd* 855 F.2d 1326 (8th Cir. 1988)	7
Wheeler v. American National Bank, 347 S.W.2d 918 (Tex. 1961)	9

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AMICUS CURIAE BRIEF OF TEXAS PROPERTY AND CASUALTY INSURANCE GUARANTY ASSOCIATION IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

Amicus curiae, the Texas Property and Casualty Insurance Guaranty Association, submits this brief which respectfully requests this Court issue a writ of certiorari to review the judgment and opinion of the United States Court of Appeals for the Eighth Circuit, filed in the above-captioned proceeding on August 26, 1988.

OPINIONS

The statement of Opinions given in the Petition for a Writ of Certiorari correctly lists the opinions in issue in this case.

JURISDICTION

The statement of jurisdiction in the Petition for a Writ of Certiorari correctly states the basis for jurisdiction.

STATEMENT OF THE CASE

A correct Statement of the Case is given in the Petition for Writ of Certiorari. For the convenience of the Court, a brief encapsulation of that statement is given below.

This matter arises from the insolvency of Transit Casualty Company (hereinafter referred to as "Transit"). At issue in this particular case are over nineteen million dollars in premiums claimed due from Wal-Mart Stores, Inc. (hereinafter referred to as "Wal-Mart") to the Receiver of Transit. Of more importance than these millions of dollars, however, is the fact that the Eighth Circuit's opinion will have adverse ramifications throughout the entire insurance industry and will threaten the financial security of all American policyholders. Given the fact that the insurance industry involves the vital public interest and the fact that insurance is the cornerstone of the financial security of almost every American, this Court should address the issue in question.

The Eighth Circuit Court of Appeals has held that the claim of the Receiver of Transit against Wal-Mart, which admittedly has acted improperly and illegally, was barred. The rationale for the ruling was that the Receiver was in *pari delicto*

with Wal-Mart. The Eighth Circuit further found that the policy in issue was tainted with illegality and could not support an action for premiums. This ruling misunderstands and misapplies the true nature of the receiver and the true rights of the innocent policyholders and other creditors of the insolvent insurance company. If allowed to stand, it fundamentally threatens the entire basis of the insurance regulatory scheme.

NATURE OF APPLICANT'S INTEREST

The Texas Property and Casualty Insurance Guaranty Association (hereinafter referred to as "Texas Association") is a statutory association of insurers comprised of insurance companies licensed to do business in the State of Texas. The Texas Association was created pursuant to Texas Insurance Code Article 21.28-C, Section 14(A). The Texas Association is charged with several duties, including the duty to pay certain "covered claims" as defined in Texas Insurance Code Article 21.28-C, Section 5(2). "Covered claims" include the

> unpaid claim of an insured or third party liability claimant which arises out of and is within the coverage and not in excess of the applicable limits of an insurance policy . . . issued or assumed . . . by an insurer licensed to do business in this State, if such insurer becomes an 'impaired insurer'

as to certain claims of residents of Texas or claims arising as to property located in Texas.

In this case, Transit sold workers' compensation insurance to Wal-Mart. Upon the insolvency of Transit, claims putatively covered under the workers' compensation policy were made upon the Texas Association for payment of alleged "covered claims" within the meaning of Article 21.28-C, Section 5(2) of the Texas Insurance Code. Obviously, there can only be a covered claim if there was a policy and a loss occurred within the terms of the policy's coverage.

The foregoing notwithstanding, Wal-Mart has illegally avoided paying the statutorily mandated insurance premiums to Transit through the fraudulent acts of both Wal-Mart and an agent of Transit acting prior to receivership. At the same time, Wal-Mart asserts that the policies of insurance issued by Transit were void for illegality, due primarily to the fraud that Wal-Mart perpetrated while acting in concert with the Transit agent. The Eighth Circuit opinion has allowed the resulting unconscionable situation to stand.

In summary, Wal-Mart underpaid Transit in excess of $19,000,000.00 in terms of the statutorily mandated rate scheme. This underpayment, pursuant to the premium agreement, made the policy illegal. Now, various workers have suffered compensable losses, but the Transit receivership estate has insufficient funds to pay the claims, in part due to Wal-Mart's failure to pay the proper premium. The Eighth Circuit should have required Wal-Mart to pay the proper premium. Instead, the Eighth Circuit's decision rewards Wal-Mart for its duplicity and fraud by providing it with a windfall in excess of $19,000,000.00. Clearly, this is wrong. The other side of the coin is that but for the Texas Association and similar Associations in other states, the workers, for whose benefit every legislature in this country has enacted workers' compensation laws, are left without the statutory coverage. If the policy was indeed illegal and void, the Associations are not required to pay the workers' claims. Moreover, the Associations are prohibited from paying such claims because a covered claim can arise only out of a valid policy. To allow such a situation to exist and to allow such a burden to fall upon innocent policy beneficiaries, who are the precise persons the legislatures intended to protect with workers' compensation insurance, would be a travesty.

Since Wal-Mart has received the benefits of millions of dollars from the Texas Association, the Texas Association now is entitled to reimbursement of these sums. The Texas Association's right to recover these sums, however, may be clouded by the Eighth Circuit's finding, at 855 F.2d 1326 n.11, which

suggests that the receiver of an insolvent insurance company must be charged with any illegal acts committed by an insolvent insurance company. This footnote may be utilized by Wal-Mart to attempt to resist payment to the Texas Association. Beyond the Texas Association, however, and beyond this particular case, the Eighth Circuit's finding imperils all policyholders everywhere. This *amicus curiae* brief is filed in support of this Court's accepting jurisdiction over this case in light of the Eighth Circuit's holding and in view of this danger.

SUMMARY OF THE ARGUMENT

This court should review the finding that under the doctrine of *pari delicto* the receiver of an insolvent insurance company has no greater rights than did the insolvent insurance company to assert a premium claim. An insurance receiver is not acting as the company but is acting as the trustee of the trust fund made up of the assets of the insolvent company. These assets of the insolvent company are for the policyholders and other creditors of the insolvent in accord with the statutory priorities. The receiver is acting in a representative capacity for the true beneficiaries of the liquidation process. These beneficiaries are not in any way in *pari delicto* and are completely innocent. Given these circumstances the true parties in interest are innocent of any wrongdoing; they are strangers to any fraudulent actions and do not stand in *pari delicto* with Wal-Mart, Transit or its agent. To penalize these innocent parties and to reward the guilty parties is so far outside the fundamental principles upon which American jurisprudence is based as to be incomprehensible. This Court should not allow the Eighth Circuit decision to stand. Because the interests involved in this appeal transcend the context in which they arise, creating serious concerns about the due process rights of statutory insurance receivers and the parties for whom they act, this *amicus curiae* brief is filed to urge this Court to accept jurisdiction over this matter and to reverse the Eighth Circuit in respect to the *pari delicto* point.

THE ARGUMENT

I. THIS COURT SHOULD HEAR THIS CASE ON THE MERITS SINCE THE EIGHTH CIRCUIT DECISION MISAPPLIES THE DOCTRINE OF PARI DELICTO IN A FASHION WHICH FORECLOSES THE DUE PROCESS RIGHTS OF INSURANCE RECEIVERS

The states have, pursuant to their police power, enacted comprehensive regulatory schemes for the insurance industry. These enactments include detailed statutes which provide for insurance company liquidations through state court receiverships.

The instant case arises from a claim by an insurance insolvency receiver. The Plaintiff is Lewis R. Crist, statutory Receiver of Transit, an insolvent Missouri insurance carrier. The Defendant in the trial court was Wal-Mart, a major Arkansas corporation and a policyholder of Transit. This suit arises out of a premium claim for $19,946,038.20 by the Receiver against Wal-Mart, seeking to recover the proper premiums due under the policy. The policy in issue was a workers' compensation policy. Workers' compensation policies are subject to premium calculation on the basis of regulatory guidelines.

An underwriter who was a sub-agent of Transit negotiated with Wal-Mart's agent for a policy of workers' compensation. However, the underwriter and Wal-Mart together reported a reduced payroll calculation for Wal-Mart. The effect of this reduced payroll was to reduce the apparent amount due for premium by Wal-Mart since payroll figures are essential to calculation of the regulatory premium due. The policy was renewed, without rectification of the misstatement.

Transit's reinsurers later noted that Wal-Mart's losses under the policy were outside the parties' expectations. The

reinsurers refused to pay claims on the Wal-Mart policies. Wal-Mart commenced litigation on the policies and Transit counter-claimed for return of premiums in an amount based upon proper calculation under the regulatory manuals.

Transit was placed into liquidation, and the Receiver was substituted as Defendant in place of Transit. After an initial empaneling of a jury, trial was made to the bench, which rendered judgment for the Receiver.

The trial court held that the doctrine of *pari delicto* had no application since the principal transaction, the issuance of the policy, was not illegal. Thus, the trial court did not discuss the issue which this brief addresses. *See Wal-Mart Stores, Inc. v. Crist,* 664 F.Supp. 1242, 1268 (W.D. Ark. 1987), *rev'd,* 855 F.2d 1326 (8th Cir. 1988).

The Eighth Circuit reversed. *See Wal-Mart Stores, Inc. v. Crist,* 855 F.2d 1326 (8th Cir. 1988). The Eighth Circuit Court of Appeals held the Receiver for Transit could not recover the premiums since the parties were in *pari delicto* as to the premium reduction scheme.

In the course of its holding, the Eighth Circuit held that the statutory receiver of an insurance company may not assert claims which would be barred for illegality had the insurance company asserted them prior to insolvency. It is this holding that this *amicus curiae* seeks to challenge, and which justifies this Court's assertion of jurisdiction over the merits of this matter.

A. An insurance company receiver is not precluded from asserting a claim merely because the claim arises from illegality involving the insolvent insurance company.

The Eighth Circuit's *pari delicto* holding was not based upon actions of the Receiver, but rather upon acts of Transit committed prior to the receivership. The issue is thus presented as to what extent the receiver of an insurance company is bound

by the illegality of the company prior to receivership. The Eighth Circuit held that the receiver was tainted with any illegality committed by the company prior to receivership. This determination is incorrect and should be corrected by this Court.

Statutory insurance receivers are appointed as an exercise of the state's police power in regulating the business of insurance. In Missouri, the Director of Insurance may be appointed receiver of an insurance company on several alternative bases of impairment or hazard, including a finding that "further transaction of business will be hazardous to its policyholders or to its creditors or to the public". Mo. Rev. Stat. §375.560. Because a statutory receiver of an insurance company exercises authority pursuant to a state administrative system of insurance regulation, deference must be given to that receiver in the exercise of his duties. *Penn General Casualty Co. v. Pennsylvania,* 294 U.S. 189 (1935). The federal system has been loathe to intrude upon the state regulatory process. *AIMS Enterprises v. Muir,* 609 F. Supp. 257 (M.D. Pa. 1985).

In this case the threatened intrusion upon state regulatory systems is not an assumption of jurisdiction, but a holding which both directly contravenes established law as to the role of an insurance receiver and frustrates the fundamental purpose of the regulation of insurance, the protection of policyholders.

Unlike the ordinary private receiver, an insurance receiver is affected with the public interest. *Anderson v. Great Republic Life Ins. Co.,* 41 Cal. App. 2d 181, 106 P.2d 75 (1940); *Insurance Commissioner v. South Carolina Life & Health Ins. Guaranty Ass'n,* 267 S.C. 378, 228 S.E.2d 273 (1976); *Kueckelhan v. Federal Old Line Ins. Co.,* 69 Wash. 2d 392, 418 P.2d 443 (1966). As such, the statutory insurance receiver may bring actions to recover for illegal transactions in which the insurance company has engaged. *Gallin v. Burdick,* 152 Misc. 468, 273 N.Y.S. 456 (Sup. Ct. 1934), *aff'd,* 265 N.Y. 492, 193 N.E. 286 (1935).

This power to bring actions in the insurance receiver includes the power to act in a capacity representative of the creditors and policyholders of the company, as well as on behalf of the company itself. *Wheeler v. American National Bank,* 347 S.W.2d 918 (Tex. 1961). This power grants the insurance receiver enhanced powers compared with those of the company prior to receivership. *See Sheeran v. Sitren,* 168 N.J. Super. 402, 403 A.2d 53 (1979).

The case law has addressed expressly this power of the receiver in suits on policies which were allegedly illegal. In *McCarthy v. Knox,* 186 S.W.2d 832 (Tex. Civ. App.—Galveston 1945, writ ref'd w.o.m.), the policyholder raised a defense strikingly similar to that raised by Wal-Mart. The Texas Court of Civil Appeals rejected this defense in light of the nature of the receiver as a representative of creditors and policyholders. Similarly, in *English Freight Co. v. Knox,* 180 S.W.2d 633 (Tex.Civ. App.-Austin 1944, writ ref'd w.o.m.), a Texas Court of Civil Appeals upheld a receiver's premium claims notwithstanding an allegation of illegality.

There is a sound basis for this line of cases. This enhanced power in the receiver stems from his administration of the affairs of insolvent insurance companies for the benefit of creditors, the policyholders and the public. *Garris v. Carpenter,* 33 Cal. App. 2d 649, 92 P.2d 688 (1939). Missouri Revised Statutes 375.650 expressly states that the receiver holds the assets of the insolvent "for the use and benefit of the creditors and policyholders of such company and such other persons as may be interested in such assets." This statute and the other relevant authority makes it clear that the receiver does not act *qua* company but acts as the representative of policyholders and other creditors.

The fact that the instant case was tried under Arkansas law does not affect the validity of the authorities cited herein. The Arkansas Supreme Court has expressly recognized the public interest with which an insurance insolvency proceeding is

charged. *See Baldwin-United Corp. v. Garner,* 283 Ark. 385, 678 S.W.2d 754 (1984), *cert. denied,* 471 U.S. 1111 (1985). The principle urged by the Texas Association has been applied in the case of an FDIC receiver for a failed bank. In *D'Oench, Duhme & Co. v. Federal Deposit Ins. Co.,* 315 U.S. 447, 62 S. Ct. 676, 86 L.Ed. 956 (1942), this Court held that an FDIC receiver is not subject to all defenses available against the pre-receivership insolvent bank. This decision was based upon the fact that a wrongdoer should not be allowed to utilize an illegality defense since the policy of the National Banking Act was to prevent parties from taking actions which impair the capital of banks. Similarly, a state insurance regulator should be entitled to enforce the obligations of a wrongdoer such as Wal-Mart even when the insurance company was chargeable with participation of the wrong.

The basic concept behind insurance is that policyholders pay money to transfer risk from themselves to an insurance company. The insurance company expects and is paid to assume commercial and natural risks. The policyholders have absolutely no control and no knowledge of the day-to-day business operations of the insurance company. The policyholders are essentially at the mercy of the insurance company except to the extent the insurance laws protect their rights. It would be wrong to hold that these policyholders, who are truly strangers to the business operations of the company, stand in *pari delicto* with the company. The very point behind the doctrine of *pari delicto* requires that the parties to whom the doctrine applies actually stand together draped in some kind of guilt. Here, the innocent policyholders and creditors are guiltless.

In its opinion, 855 F.2d at 1335 n.11, the Eighth Circuit recognized the line of cases discussed above but refused to follow them, holding that no authority exists for the proposition that insurance receivers have powers similar to that of receivers of banks. This holding demonstrates the depth of the Court of

Appeals' misunderstanding of the nature of an insurance receiver.

If the Court of Appeals' ruling is allowed to stand, then no policyholder can rest assured that his or her policy means anything. Here, there was a statute which mandated the proper premium. This statute is deemed to have been incorporated into the contract and private parties cannot contract around the law. *See Connolly v. Pension Benefit Guaranty Corp.*, 475 U.S. 211, 106 S.Ct 1018 (1986); *Alpha Beta Food Markets, Inc. v. Retail Clerks' Union Loan 777*, 45 Cal.2d 764, 291 P.2d 433 (1955). This rule should result in a finding that the premium scheme, not the entire policy, was illegal. The result should be that the courts should read the statutorily mandated rates into the policy and force Wal-Mart to obey the law. The Court of Appeals has, instead, allowed the wrongdoers to profit.

In addition, if the Court of Appeals' opinion is allowed to stand, all policyholders would be constantly at risk that the actions of the insurance company would be asserted by the insurance company's fellow wrongdoers to avoid obligations to policyholders. The harshness of the Eighth Circuit's opinion is illustrated in the following example. Assume a large insurance company collects hundreds of millions of dollars from the public in premiums and then obtains reinsurance. This same company and its reinsurers enter into an illegal scam in connection with the reinsurance. The insurance company then becomes insolvent. Does the Eighth Circuit's opinion mean that the policyholders cannot, through the receiver, collect the reinsurance because the reinsurers and the company were in *pari delicto*? This cannot be the law in this country. However, application of such a rule would provide a windfall and immunity to all manner of insurance wrongdoers from the sweat of the brow of the American public. The *pari delicto* rule makes sense as an effort to curb the ability of conspirators to profit from the illegality which taints a transaction. However, it is illogical to apply that rule to an insurance receiver, who is, by

definition, acting only in a representative capacity for innocent parties. The cases involving receivers have never applied *pari delicto* to such a receiver, and this Court should review the erroneous decision of the Eighth Circuit to apply that doctrine in this context.

II. THE COURT OF APPEALS INVADED THE POLICE POWER OF THE STATE INSURANCE REGULATOR BY REFUSING TO ENFORCE THE PREMIUM LIABILITY

In addition to the foregoing concerns, the Eight Circuit's holding is in direct contravention to the established case law concerning illegal attempts to circumvent insurance regulations. In the case of *Bowen Motor Coaches, Inc. v. New York Casualty Co.*, 139 F.2d 332 (5th Cir. 1943), the court reformed a policy with an inaccurate account stated to accurately reflect the amount of premium due under the workers' compensation statutes. Such a reformation is a recognition of the state regulatory interests involved in the business of insurance. An insurance company is a highly regulated entity which must maintain reserves in accordance with law. The policyholders of an insurance company rely upon the insurance company to maintain its adequate reserves and to engage in pricing practices consistent with law. In this case, there is no question that Wal-Mart attempted to circumvent the rate regulations for workers' compensation policies. Accordingly, Wal-Mart should be held estopped to deny that it purchased a workers' compensation policy for which premiums would be due on a statutorily-calculated basis. Wal-Mart should not be permitted to escape its liabilities since it admittedly knew the basis on which premiums would have been calculated. To permit Wal-Mart to circumvent the statutory ratemaking scheme for workers' compensation premiums would be an invasion of the rights of the Transit Receiver in his capacity as trustee for the benefit of Transit's policyholders and creditors.

In this context, the *D'Oench* case also serves as a useful analogy. Indeed, it has been held that a party is *estopped* from denying the legality of a transaction where the plaintiff is the FDIC. *See F.D.I.C. v. Oehlert,* 252 N.W.2d 728 (Iowa 1977). *Oehlert* discusses extensively the federal policy preventing those dealing with banks from entering into transactions which result in a misstatement of surplus. A directly analogous argument may be made in the insurance insolvency context. In *Bonhiver v. Graff,* 311 Minn. 111, 248 N.W.2d 291 (1976), an alleged negligent tortfeasor contended that the fraud of the insurance company was the true cause of the tort. The Minnesota Supreme Court rejected this argument, holding an insurance receiver has enhanced rights due to his representation of creditors and policyholders. The application of this principle is even more clear in the case of a party whose actions amount to a fraud. *See Magnusson v. American Allied Ins. Co.,* 290 Minn. 465, 189 N.W.2d 28 (1971). As the Minnesota Supreme Court expressly recognized in *Magnusson,* an insurance company receiver is not bound by the fraud of the company he represents, since he represents not only that company but also the policyholders and creditors of the company.

The Eighth Circuit opinion flies in the face of the insurance regulatory scheme of the several states. The Court of Appeal's limitation on the rights of the insurance receiver is simply not supportable in light of either the case law, the statutory provisions, or the public policy of the states. Nevertheless, the decision injects an element of uncertainty into insurance receiverships which has been felt outside the confines of the facts of the case. This Court should grant certiorari in this case to prevent this newly-injected confusion from impairing the ability of the states' insurance regulators to proceed against the wrongdoers who contribute to the downfall of the insurance company and to protect the insurance-buying public.

This case is of concern to regulators in each of the nineteen states in which Wal-Mart's transaction occurred. This concern

arises from the fact that the insurance guaranty association (or other protective entity) in each state must confront the treatment of claims filed by Wal-Mart against their statutory coverage. For example, the Texas Association has paid claims on the basis of policies which Wal-Mart now asserts are void. Significantly, Wal-Mart may seek to utilize *pari delicto* as a weapon in the claim of the Texas Association for return of these payments under putatively void policies. This Court should clarify the application of the *pari delicto* doctrine through grant of a writ of certiorari in this case.

CONCLUSION

This case involves issues of national significance to insurance regulators. The Eighth Circuit's holding jeopardizes the rights of insurance receivers to collect assets of the estates of defunct insurance companies from the wrongdoers who caused dissipation of these assets. There are endless permutations of the kinds of illegal schemes that could be created. If such schemes can be used to void policyholder rights under policies and to avoid payment of premiums or reinsurance recoverables or other debts to the receiver, then the only fund the policyholders have to look to, the assets of the insolvent, will be gone. The capital and surplus requirements of the various state statutes will be meaningless. The Guaranty Associations will be powerless to pay claims on non-existent policies. Even if the Associations did pay, these funds are eventually derived from the citizens either in premium tax off-sets or in premium surcharges. What would be the point of insurance?

This Court should grant certiorari to remedy the error committed by the Eighth Circuit.

Respectfully submitted,

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KARL L. RUBINSTEIN